DEPARTMENT OF THE TREASURY
INTERNAL REVENUE SERVICE
WASHINGTON, D.C. 20224

OFFICE OF
CHIEF COUNSEL

MEMORANDUM FOR Debra Cowen, Exempt Organizations Division
Tax Exempt and Governmental Entities

FROM: Stephen Fattman, Assistant to the Chief, CC:CORP:4

SUBJECT: [redacted]
FREV-119452-01, WLI 2

We are responding to your April 17, 2001 request for technical assistance on the taxpayer's request for a ruling that its conversion from a taxable corporation to a tax-exempt organization will not cause recognition of gain or loss under § 1.337(d)-4 of the Income Tax Regulations. We request that the following facts, representations, ruling, and caveats be included in your reply. We would like to see the final draft of the ruling before it is issued.

LEGEND:

Taxpayer = [redacted]

Year A = [redacted]

Year B = [redacted]

Date Y = [redacted]

Agreement = [redacted]

Programmer = [redacted]

a = [redacted]

b = $[redacted]

c = $[redacted]

PMTA: 01338

d = $[redacted]

Taxpayer is a taxable C corporation that publishes an ethnically-oriented newspaper (and related cultural activities) on a nonprofit basis, and also operates a commercial radio station (the Station) for profit. The Internal Revenue Service (IRS) recognized Taxpayer as a tax-exempt § 501(c)(4) social welfare organization in Year A, but retroactively revoked that exemption in Year B. Years A and B were both before 1997.

Taxpayer is seeking to regain § 501(c)(4) tax-exempt status from the IRS. Taxpayer will neither have to amend its charter nor transfer assets to another entity to qualify for such status. However, we understand that, to obtain tax exemption, Taxpayer will have to discontinue operating the Station by either leasing its airtime to a station operator or selling the Station.

On Date Y, Taxpayer entered into the Agreement with Programmer that provides both a license for Programmer to use the airtime on the radio station for two years in exchange for a royalty of a and an option (Option) that allows Programmer to negotiate the Programmer's purchase of the station's operating assets from Taxpayer for a fixed purchase price of b at any time during the two-year term. The Agreement will not take effect until after the tax rulings requested in this case are issued and certain regulatory approvals are obtained. Programmer agreed to pay a premium for the Option of c, which if the Agreement goes into effect, Taxpayer will retain whether or not Programmer exercises the Option. The Agreement states that, upon exercise of the Option, the parties must negotiate, in good faith, the sale of the Station. The Agreement specifies several terms, in addition to the price, that would govern such purchase. If the Option is exercised but an agreement is not reached, Programmer can extend the license for five years in exchange for a royalty of d. In the event of Taxpayer's default under the Agreement, Programmer has a right of specific performance.

Taxpayer represents that:

(a). To the best of the taxpayer's knowledge and belief, the b exercise price of the option represents the fair market value of the radio station.

(b). To the best of the taxpayer's knowledge and belief, the royalty payments specified in the Local Marketing Agreement represent the fair market value of the right to use the airtime of the radio station under the terms of that Agreement.

Section 337(d) authorizes regulations to prevent avoidance of the repeal of the General Utilities doctrine, including prevention of the circumvention of those provisions through the use of a tax-exempt entity. Under § 1.337(d)-4(a)(1), if a taxable corporation transfers all or substantially all of its assets to a tax-exempt entity, the taxable corporation generally must recognize gain or loss as if the assets transferred were sold at their fair market values. Under § 1.337(d)-4(a)(2), a taxable corporation's change in status to a tax-exempt entity generally will be treated as if it transferred all its assets to a tax-exempt entity in a transaction subject to gain or loss recognition.

Section 1.337(d)-4(a)(3)(i)(B) provides that § 1.337(d)-4(a)(2) does not apply to a corporation that was previously tax-exempt under § 501(a) or that applied for but did not receive recognition of exemption under § 501(a) before January 15, 1997, if such corporation is tax-exempt under § 501(a) within three years from January 28, 1999.

Based solely on the information submitted, we rule that Taxpayer is a corporation described in § 1.337(d)-4(a)(3)(i)(B), provided that Taxpayer obtains tax-exempt status within three years from January 28, 1999. Accordingly, subject to the proviso in the preceding sentence, upon the change of Taxpayer to a tax-exempt entity, Taxpayer will not be treated as if it transferred all of its assets in a taxable transaction pursuant to §§ 1.337(d)-4(a)(1)) and 1.337(d)-4(a)(2).

We express no opinion as to whether (a) if the Option is exercised by Programmer and the Station is sold, Taxpayer's receipt of the proceeds from the sale of the radio station will be treated as gain or loss recognized by Taxpayer before its change in status to a tax-exempt entity, and (b) whether or not the option is exercised, whether the premium paid for the option by Programmer, upon the exercise, lapse, or disposition of the option, will be treated as income, gain or loss received by Taxpayer before its change in status to a tax-exempt entity. These are questions of fact that can only be decided on examination of the federal income tax or exempt organization returns of Taxpayer by the appropriate office or offices of the IRS.

We also express no opinion on the tax treatment of Taxpayer's change in status to a tax-exempt entity, the airtime license for the Station, or the possible sale of the Station under other provisions of the Code or regulations (including provisions relating to depreciation recapture or investment credit recapture) or the tax treatment of any condition existing at the time of, or effect resulting from, the transaction not specifically covered by the above ruling.